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TAGS: EFIN, UK

SUBJECT: EUROCURRENCY MARKET DEVELOPMENTS

SUMMARY: DURING PAST TWO WEEKS, FINANCIAL ATTACHE HAS DISCUSSED EMERGING TRENDS IN EUROCURRENCY MARKET WITH U. S. BANKS AND INVESTMENT HOUSES, INCLUDING SPECIAL SESSION WITH REPRESENTATIVES OF AMERICAN BANKS ASSOCIATION IN LONDON (ABAL), UK CLEARING BANKS AND MERCHANT BANKS, AND BANK OF ENGLAND. MAIN FOCUS OF DISCUSSIONS WAS ON EMERGING

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TRENDS, OUTLOOK OVER NEXT SIX MONTHS. BANKS REPRESENTED AT THE ABAL SESSION WERE FNB BOSTON; CHASE MANHATTAN;

MORGAN GUARANTY; FIRST NATIONAL CHICAGO; FIRST NATIONAL CITY BANK, NEW YORK; FNB DALLAS; AND BANK OF AMERICA. REPRESENTATIVES WERE MIXTURE OF SENIOR OFFICERS AND OPERATING PERSONNEL. DISCUSSIONS WITH ABAL DIVIDED INTO TWO PARTS. FIRST, LIABILITY (DEPOSIT) DEVELOPMENTS; SECOND, ASSET MANAGEMENT (LENDING) DEVELOPMENTS. GENERAL COMMENTS OF BANKERS TOUCHED ON CAPITAL ADEQUACY CONCERNS WHICH ARE REDUCED; INCREASED CONFIDENCE IN ABILITY TO DEAL WITH RECYCLINE; EFFECT OF RECESSION ON BALANCE SHEETS, INCLUDING FALL OFF IN LOAN DEMAND IN THE US; CONCERNS ABOUT TRENDS TOWARD NARROWING SPREADS, REDUCED FEES, LENGTHENING MATURITIES IN INTERNATIONAL LENDING; REDUCED CREDIT WORTHINESS OF SOME LDC BORROWERS; AND LIKELY PICKUP IN LOAN DEMAND NEXT YEAR, WITH EXPECTED UPWARD PRESSURE ON INTEREST RATES. BANKERS CONSIDERED MARKETS HAD DIGESTED US PROBLEMS FAIRLY WELL, INCLUDING REITS, W.T. GRANT, AND NEW YORK CITY, ALTHOUGH NEW YORK CONTINUES TO CREATE CONCERN, IN LARGE PART BECAUSE OF UNCERTAINTIES INVOLVED. CONTINUED STRONG ACTIVITY FORESEEN IN EUROBOND MARKETS INTO 1976. MORE NORMAL YIELD CURVE IN U.S. HAS HELPED EURO-MARKETS AND STERLING; BUT STERLING WILL WEAKEN FURTHER. END SUMMARY.

1. STRUCTURE OF THIS AND NEXT MAIN SECTION OF CABLE FOLLOWS FORMAT OF ABAL DISCUSSION, BUTTRESSED BY ADDITIONAL CONVERSATIONS. INITIAL DISCUSSION CENTERED ON BANK LIABILITY -- DEPOSIT CONSIDERATIONS. BANKERS' FEARS ABOUT THEIR ABILITY TO HANDLE OPEC DEPOSITS HAVE BEEN REDUCED. INITIALLY THERE HAD BEEN FEARS THAT THE BANKING SYSTEM COULD NOT MANAGE THE FUNDS. AFTER PERIOD OF UNCERTAINTY, THERE IS CONSIDERABLY MORE CONFIDENCE. THE NUMBER OF MAJOR BANKS USED BY OPEC DEPOSITORS SEEMS TO HAVE STABILIZED AT ABOUT 45 TO 50. BANKS INITIALLY RECEIVING OPEC DEPOSITS IN TURN PLACE THEM WITH PERHAPS UP TO 200 ADDITIONAL BANKS. MATURITIES ARE LENGTHENING. CONSIDERABLE FUNDS ARE STILL PLACED AT SHORT TERM ALTHOUGH INCREASINGLY MATURITIES OF ONE TO THREE YEARS ARE SEEN AND ACCEPTED. THERE APPEARS TO BE A TENDENCY FOR LONGER TERM MATURITIES TO BE PLACED IN THE COUNTRY IN WHICH THE DEPOSIT CURRENCY IS DENOMINATED. LIMITED OFFICIAL USE

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TED, I.E., LONGER TERM DOLLAR DEPOSITS IN THE U.S., FRENCH FRANC DEPOSITQ IN FRANCE, STERLING IN THE UK, ETC.

2. OPEC DEPOSITORS HAVE BECOME MORE SOPHISTICATED, GENERALLY SEEKING BIDS RATHER THAN OFFERING FUNDS. TIERING STILL EXISTS BUT IN A MUCH REDUCED WAY. FRENCH AND UK CLEARING BANKS PAY MORE FOR LONGER TERM DOLLAR DEPOSITS (DEFINED AS OVER ONE YEAR) THAN DO U.S. BANKS. IN ADDITION, OPEC DEPOSITORS MORE FREQUENTLY UTILIZE THE LONDON BROKING SYSTEM (UP TO FOUR BROKERS MENTIONED AS BEING

NOTICEABLY ACTIVE). IMPROVED TELEX FACILITIES WITH SAUDI ARABIAN MONETARY AUTHORITY ALSO NOTED (APPARENTLY THE 2ND MACHINE HAS BEEN INSTALLED).

3. ONE MEDIUM-SIZED U.S. BANK REPORTED IN CONFIDENCE THAT IT HAD JUST BEEN PLACED ON LIST OF AUTHORIZED SAMA DEPOSITORIES. IT DOES NOT EXPECT TO SEE MUCH STERLING FROM SAMA BUT IS TAKING YEN FOR USE IN JAPAN, DM FOR USE IN GERMANY AND CONSIDERABLE EURODOLLAR DEPOSITS. DOLLAR FUNDS WILL BE USED IN U.S., BUT SAMA INSISTED ON THE INITIAL PLACING WITH LONDON BRANCH TO BENEFIT FROM HIGHER EURODOLLAR RATES

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BANK ADMITS RESULT IS THAT ITS OWN MARGIN (BETWEEN BID RATE IN LONDON AND OFFER RATE IN U.S.) WILL BE NARROWER, YIELD LESS PROFIT, BUT CONSIDERS THIS FAIR INSURANCE TO GET THE 2 TO 5-YEAR MATURITIES INVOLVED.

4. WITH CUTBACK IN OPEC PRODUCTION AND INCREASED OPEC IMPORTS, SIZE OF THE GLOBAL FLOWS ARE LESS OF A PROBLEM, ALTHOUGH SPECIFIC LARGE DEPOSITS STILL CAN CREATE DIFFICULTIES FOR INDIVIDUAL BANKS IN MANAGING THEIR BOOKS AND OVERALL MAGNITUDE OF DEPOSITS IS STILL VERY LARGE. DESIRE OF SOME DEPOSITORS (READ SAUDI ARABIA AND KUWAIT) FOR ANONYMITY ALSO NOTED. SOME OPEC DOLLAR DEPOSITS ARE LIMITED OFFICIAL USE

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PLACED INITIALLY IN SWITZERLAND WITH SWISS BANKS, WHICH IN TURN PLACE THEM WITH LARGEST U.S. BANKS IN LONDON, RAISING PRICE PAID FOR FUNDS BY THE U.S. BANKS BY AN EIGHTH. US BANKS FEAR IF THEY ARE FORCED TO MAKE INFORMATION ON SOURCE OF DEPOSITS PUBLIC KNOWLEDGE IN RESPONSE TO CONGRESSIONAL INITIATIVES, THIS WILL HURT US BANKING COMMUNITY'S ABILITY TO COMPETE FOR FUNDS, AT LEAST DIRECTLY. BANKERS ACKNOULEDGE PRACTICAL EFFECT (ASIDE FROM RAISING PRICE) OF INITIAL DOLLAR PLACEMENTS WITH CONTINENTAL RATHER THAN U.S. BANKS SIMPLY PLACES US BANKS ONE FURTHER STEP DOWN IN THE INTERMEDIARY CHAIN.

5. PARADOXICALLY, US BANKERS (WHOSE OPINIONS CONFIRMED BY UK CLEARING BANK OFFICIALS) REPORT THAT MANY CONTINENTAL AND UK BANKS ARE UNWILLING TO SIGNIFICANTLY INCREASE THEIR TAKINGS OF DOLLAR DEPOSITS; THEY BACK AWAY FROM DOLLAR DEPOSITS OVER 25 MILLION DOLLARS BECAUSE OF UNCERTAINTY ABOUT THEIR ABILITY TO LAY OFF THESE FUNDS. US BANKS HAVE A REAL ADVANTAGE IN ACCEPTING LONGER TERM DOLLAR DEPOSITS (DEFINED AS FROM 2 TO 5-YEAR MATURITIES) ON WHICH US BANKS MAY BE ABLE TO OBTAIN FUNDS FROM 1/4 TO 1/2 PERCENT BELOW NOMINAL RATES BEING PAID IN STATED MATURITY RANGE. MAJOR CONTINENTAL AND UK BANKS WOULD SOMETIMES PAY 1/16 TO 1/8 ABOVE THE GOILG NOMINAL INTERBANK RATE IN THESE MATURITY RANGES. JAPANESE BANKS GENERALLY STILL PAY ABOUT 1/8 PERCENT OVER THE NOMINAL BID RATE FOR DEPOSITS, WHICH IS NOT CONSIDERED SIGNIFICANT. DECLINE IN THE JAPANESE PREMIUM ATTRIBUTED PARTLY TO THE FACT THAT THEY ARE NOT AS ACTIVE TAKERS AS THEY HAD BEEN, AND PARTLY TO FACT THAT EUROCURRENCY MARKET CURRENTLY VERY LIQUID.

6. CONTINUE GROWTH IN OFFSHORE BANKING IN THE BAHAMAS ATTRIBUTED TO CONVENIENCE AND LACK OF TAXATION. FOR MANY U.S. BANKS, NASSAU IS CONSIDERED AN EXTENSION OF LONDON AND NEW YORK ACTIVITIES. HEAVIEST CONCENTRATION OF ACTIVITY

IS IN THE 3 TO 6-MONTH MATURITY RANGE, SOMETIMES STRETCH-
ING TO 9 TO 12-MONTH MATURITIES. BOTH BAHAMAS AND SINGA-
PORE MENTIONED AS MAJOR NET TAKERS OF FUNDS WITH NO NATUR-
AL INFLOW. THEY ARE VERY ACTIVE IN BIDDING FOR DEPOSITS.
MOST LOANS FOP 3 TO 6 MONTHS ARE MADE SUBJECT TO AVAILABI-
LITY. CONFIDENTIAL BANK OF ENGLAND STATISTICS ON ACTIVI-
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TIES OF AMERICAN BANKS IN LONDON BEAR THIS OUT WITH END
SEPTEMBER LIABILITIES OF AMERICAN BANKS IN LONDON TO
BAHAMAS OF 1.7 BILLION POUNDS AND CLAIMS OF 3.7 BILLION
POUNDS. (SIMILAR FIGURES FOR SINGAPORE ARE LIABILITIES
AT 129 MILLION POUNDS, CLAIMS OF 957 MILLION POUNDS.)
BECAUSE NASSAU IS NOT BIG ENOUGH TO HANDLE ALL BORROWERS,
FUNDING COMES FROM LONDON AND ELSEWHERE. INITIAL VIEW OF
U.S. BANKERS IS THAT U.K. AGREEMENT TO TAKE STEPS TO PUT
U.S. BRANCH BANKS IN UK ON SAME FOOTING WITH RESPECT TO
FOREIGN TAX CPEDITS AS UK BANKS IS BOUND TO SHIFT SOME
NASSAU BUSINESS BACK TO LONDON.

7. EFFECT OF NEW YORK CITY CRISIS IS SEEN BY U.S. COMMER-
CIAL BANKERS AS SIGNIFICANT, CAUSING UNCERTAINTY WHICH
FINANCIAL SYSTEM DOESN'T LIKE. EUROPEANS HAVE A DISTORTED
VIEW OF WHAT A DEFAULT WOULD MEAN. THEY DON'T RECOGNIZE
HOW U.S. FEDEPALISM WORKS. IN LONDON, THERE ARE SOME
SHIFTS OF DEPOSITS FROM NEW YORK TO OTHER MAJOR CITY BANKS
WHICH WE ARE TOLD ARE RECYCLED BACK THROUGH INTERBANK
MARKET AS NEEDED, WITH NEW YORK BANKS PAYING A BIT MORE
FOR FUNDS. ONE SOURCE SAYS SOME TIERING HAS DEVELOPED,
WITH SOME NON-NEW YORK BANK CDS QUOTED AT 1/8 LESS THAN
NEW YORK BANKQ CDS. NEW YORK BANKS REPORTEDLY HAVE BEEN
POSITIONING THEMSELVES BY GOING LONG ON DOLLARS, IN EFFECT
PREFINANCING IN ANTICIPATION OF SOME RUN OFF IN DEPOSITS.

8. ASIDE FROM NEW YORK COMMERCIAL BANKS, THERE IS GENERAL
SENTIMENT THAT THE EFFECTS OF A NEW YORK CITY DEFAULT ARE
BY NOW LARGELY DISCOUNTED. THIS IS VIEW OF TWO MAJOR US
INVESTMENT HOUSES IN LONDON AS WELL AS SOME OF NON-NEW
YORK BANKS; MAIN POINT MADE BY THESE INSTITUTIONS IS THAT

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IT IS ESSENTIAL THAT FEDERAL RESERVE BE SEEN TO BE FULLY
SUPPORTING THE SYSTEM, IN WHICH CASE DEFAULT WILL CREATE
RIPPLES IN FINANCIAL SYSTEM, BUT NO MAJOR WAVES. NO SIG-
NIFICANT LONG-TERM LOSS OF INTERNATIONAL STATURE SEEN FOR
MAJOR NEW YORK BANKS. VIEWS DIVIDED ON ANY LASTING
INCREASED BENEFIT FOR REGIONAL U.S. BANKS, ALTHOUGH AT
LEAST ONE SOUTHWEST U.S. BANK REPORTS GROWING CONTACTS
WITH OPEC DEPOSITORS AT THEIR INITIATIVE. ONE BUSINESS
NEWSLETTER HERE SEES THE IMPACT ON INTERNATIONAL FINANCIAL
MARKETS LIKELY TO BE MORE PSYCHOLOGICAL THAN REAL; ONE
COULD SEE A SHARP DROP IN WALL STREET INFECTING AMSTER-
DAM, ZURICH AND FRANKFURT, BUT THIS SETBACK QUOTE WOULD
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PRESENT A BUYING OPPORTUNITY BECAUSE THE LIKELY IMPACT OF
A NEW YORK DEFAULT HAS BEEN EXAGGERATED IN ORDER TO
PRESSURIZE THE WHITE HOUSE UNQUOTE.

9. SENIOR BANK OF ENGLAND, H.M. TREASURY STAFF, SOME NEW YORK AND UK CLEARING BANKERS SUGGEST THAT DESPITE HEAVY TESTIMONY FROM SECRETARY SIMON AND CHAIRMAN BURNS, FAVORABLE AND CALMING INTERNATIONAL IMPACT WOULD RESULT FROM A SPEECH OR MESSAGE AIMED DIRECTLY AT INTERNATIONAL FINANCIAL COMMUNITY WHICH WOULD OUTLINE IN SIMPLE, STEP-BY-STEP FASHION WHAT FINANCIAL IMPACT OF A DEFAULT BY NEW YORK WOULD MEAN FOR THE FINANCIAL SYSTEM, AND HOW FED AND FDIC WOULD SUPPORT THE SYSTEM AT EACH STAGE IN A DEFAULT.

10. ON THE LENDING SIDE (I.E., ASSET MANAGEMENT) TOP CATEGORY BORROWERS ARE GETTING FUNDS AT UP TO ONE YEAR'S MATURITY AT 3-4 TO 7/8 PERCENT SPREAD OVER THE LONDON INTERBANK OFFER (LIBO) RATE. MATURITIES OF FROM THREE TO FIVE YEARS ARE BEARING A SPREAD OF 1-1/4 PERCENT; MATURITIES UP TO 7 YEARS ARE PAYING 1-3/8 OVER ALTHOUGH IN SOME CASES THE SPREAD IS AS THIN AS 1-1/4 IF THERE IS HEAVY PRESSURE FROM A STRONG BORROWER. SPREADS DEFINITELY ARE NARROWING. THERE IS INCREASING PRESSURE ON MANAGEMENT FEES AND OTHER CHARGES AS WELL, COUPLED WITH COMPETITION TO EXTEND MATURITIES. COMMITMENT FEES WHICH HAD BEEN OVER ONE PERCENT ARE NOW REDUCED TO 1/2 PERCENT; MANAGEMENT FEES ARE IN THE RANGE OF 3/8 TO 1/2 PERCENT ON SYNDICATED ISSUES. THERE IS STILL REASONABLE RESISTANCE FROM THE BANKS TO EXTENDING 7-YEAR MATURITIES ALTHOUGH "CHINKS IN THE ARMOR ARE APPEARING WEEKLY IF NOT DAILY." ANY MAJOR BORROWER WHO HAS BEEN OUT OF THE MARKET FOR 12 TO 18 MONTHS CAN PROBABLY NEGOTIATE A LOAN AT FAVORABLE TERMS. GOVERNMENT OF AUSTRIA SYNDICATED ISSUE CITED AS AN EXAMPLE THERE IS SOME DISAGREEMENT AMONG THE BANKERS ABOUT HOW RAPIDLY SPREADS AND MATURITIES ARE ERODING, BUT WEAK LOAN DEMAND IN THE U.S. IS CITED AS ONE ELEMENT INCREASING THE SUPPLY OF FUNDS IN THE EURO CURRENCY MARKET. THIS MUCH SAID, THERE IS DETERMINATION NOT TO LET COLLECTIVE GREED REDUCE SPREADS TO THE LEVELS THAT WERE PREVAILING IN 1973 AND 1974.

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11. LOOKING AHEAD, THERE IS EXPECTATION THAT 1976 WILL SEE HEAVY DEMANDS FOR BALANCE OF PAYMENTS AND PROJECT LOANS FROM SMALLER INDUSTRIALIZED COUNTRIES AS WELL AS LESS DEVELOPED COUNTRIES. SOME CONSORTIUM BANKS REPORTEDLY WILL HAVE A RUN OFF IN THEIR PORTFOLIOS DURING 1976 AND BE UNDER INCREASED PRESSURE TO PRODUCE FEES AND EARNINGS. MUCH SOVEREIGN RISK AND PRIVATE SECTOR LENDING THAT MIGHT BE DIFFICULT TO ARRANGE FOR A 5-YEAR PERIOD CAN BE UNDERTAKEN FAVORABLY ON A ONE-YEAR BASIS. WHEREAS BANKS ARE RESISTING MATURITIES ABOVE FIVE YEARS AND

EROSION OF SPREADS, BORROWERS ARE RESISTING SHORTER ONE
TO TWO YEAR MATURITIES BEING OFFERED.

12. THE DEVELOPMENT SEEN DURING PAST 12 TO 18 MONTHS OF
FEWER BANKS PARTICIPATING IN SYNDICATED LOANS SHOWS SOME
SIGNS OF CHANGE. INCREASINGLY, A LARGER NUMBER OF BANKS
INDICATE A WILLINGNESS TO PARTICIPATE. ON THE OTHER
HAND, SOME NEW ISSUES ARE SHOWING EVEN A MORE REDUCED NUM-
BER OF BANKS PARTICIPATING AND THESE ARE ON UNDERWRITING
RATHER THAN A BEST EFFORTS BASIS. THE NEED FOR FIRM UNDER-
WRITING IS SEEN AS A REACTION TO MARKET UNCERTAINTY, PAR-
TICULARLY ON LOANS TO LESS THAN PRIME OR FIRST CLASS BOR-
ROWERS.

13. THE BANKERS THOUGHT THAT ALMOST ALL MAJOR EUROPEAN
COUNTRIES WILL CONTINUE BORROWING IN THE INTERNATIONAL
MARKETS. IN CONVERSATIONS BEFORE AND AFTER ANNOUNCEMENT
OF INTENTION TO DRAW FROM IMF, THEY FELT THAT THE UK GOV-
ERNMENT IF IT WISHED COULD BORROW BETWEEN 500 MILLION AND
A BILLION DOLLARS AT A 5-YEAR MATURITY, WITH UP TO 500
MILLION DOLLARS OF SUCH AN ISSUE CARRYING A 1-1/4 PERCENT

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SPREAD. CLEAPING BANKS WOULD BE EXPECTED TO TAKE THE LEAD. EXPECTATION WOULD BE THAT THERE WOULD BE LARGE NUMBER OF U.S. BANKS INVOLVED, BUT FOR SMALLEST AMOUNTS THEY COULD RESPECTABLY TAKE.

14. SOME U.S. BRANCHES HAVE QUIETLY BEEN SEEKING CONFIRMATION FROM H.M. TREASURY ABOUT HOW MUCH BACKING AND SUPPORT LOCAL AUTHORITIES CAN EXPECT FROM CENTRAL GOVERNMENT SHOULD LOCAL AUTHORITIES RUN INTO DIFFICULTY IN MAKING LOAN REPAYMENTS. POOR FINANCIAL CONDITION OF GREATER LONDON COUNCIL AND SOME REGIONAL CITIES APPARENTLY PROVOKED THE QUESTION. SOME U.S. BANK BRANCHES EXPECT TO

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SHOW LOSSES ON LOANS TO CHRYSLER, UK. THIS MUCH SAID, US BANKS SAY THEY ARE ACTIVE IN FINANCING UK CORPORATE SECTOR, BOTH IN STERLING AND DOLLARS. THEY REPORT THERE IS STILL GOOD CORPORATE BUSINESS TO BE DONE, ALTHOUGH PRIMARILY WITH UI COMPANIES NOT TOTALLY DEPENDENT ON THE UK ECONOMY FOR THEIR PROFITS.

15. BANKERS GENERALLY SANGUINE ON THE OUTLOOK FOR NORTH SEA LENDING. LOANS ARE STILL BEING MADE AND MANY MORE ARE UNDER DISCUSSION, ALTHOUGH THE REPUTATION AND FINANCIAL STRENGTH OF THE MAJOR OIL COMPANIES INVOLVED WEIGH HEAVILY IN BANKERS' ESTIMATION AND DECISIONS MADE. WHEREAS SOME OFF-BALANCE SHEET FINANCING MIGHT BE POSSIBLE, IT NONETHELESS WOULD BE DIFFICULT AND AN EXCEPTION TO THE RULE. AN INCREASE IN BORROWING DEMAND FOR NORTH SEA DEVELOPMENT IS EXPECTED NEXT YEAR. BANKERS LARGELY ECHOED THE EMBASSY'S RECENT REPORTING ON NORTH SEA FINANCIAL DEVELOPMENTS IN ENCLOSURE 2 TO LONDON A-821 TO WHICH READERS ARE REFERRED.

16. COUNTRY LIMITS REMAIN UNDER CLOSE SURVEILLANCE AND CONSTANT REVIEW. SIMILAR ATTENTION IS ALSO PLACED ON THE PORTFOLIO MIX IN TERMS OF COMPANIES, INDUSTRIES, ETC. IN MANY CASES, THE HIGHER SPREAD CHARGED TO MORE RISKY BORROWERS DOES NOT ADEQUATELY REPRESENT THE REAL RISK INVOL-

VED. A SPREAD OF 2 AND 2-1/8 OVER LIBO WAS TERMED THE ARTIFICIAL UPPER LIMIT FOR A RISKY BORROWER, ALTHOUGH FEES MIGHT ALSO BE ADJUSTED TO TAKE ACCOUNT OF THE HIGHER RISK. THERE IS EXPECTATION THAT 1976 WILL RESULT IN BAD DEBT EXPERIENCE IN BLACK AFRICA AND PARTS OF LATIN AMERICA INCLUDING BRAXIL AND ARGENTINA. IN LESS DEVELOPED AREAS, THE COMMERCIAL RISKS ARE OFTEN CONSIDERED AS MORE FAVORABLE THAN SOVEREIGN RISK, ESPECIALLY WHEN DEALS ARE SO STRUCTURED THAT REPAYMENTS ARE MADE TO THE BANKS OFFSHORE IN ORDER TO AMORTIZE A PARTICULAR PROJECT.

17. THERE REMAINS CONSIDERABLE INTEREST IN LENDING TO THE SOVIET UNION. THE BANKERS COMPLAIN BITTERLY ABOUT THE PRESSURE PUT MN THEM TO NARROW THE SPREAD ON LOANS TO USSR, BUT THEY CONTINUE TO PUT UP THE MONEY. ONE REASON IS THAT MANY BANKS WISH TO DIVERSIFY THEIR SOVEREIGN RISKS LIMITED OFFICIAL USE

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AND SEE THE UQSR AS A BETTER RISK THAN SOME SOUTH AMERICAN AND AFRICAN COUNTRIES. MUCH OF THE LENDING TO THE USSR REPRESENTS EXPORT FINANCING. THERE ARE COMPLAINTS THAT LENDING TO THE USSR IS IN EFFECT MONEY BROKING WITH VERY LITTLE OF THE SIDE BENEFIT RESULTING IN THE NORMAL BANK/CLIENT-RELATIONSHIP SENSE.

18. THE FOREIGN EXCHANGE MARKETS ARE VERY DIFFERENT NOW FROM WHAT THEY WERE 18 MONTHS AGO. CONTROLS AND SUPERVISION ARE BETTER, WITH ATTENTION PAID TO RISKS AND THE PARTNERS IN THE DEAL. THE MARKET IS CHARACTERIZED AS THI AND ON OCCASION HEAVILY INFLUENCED BY THE GERMAN BANKS MOVING IN ONE DIRECTION OR ANOTHER. ALTHOUGH IT CAN BE VOLATILE, ITS BASIC UNDERPINNINGS AND STRUCTURE ARE SEEN AS CONSIDERABLY IMPROVED.

19. THE RECENT STRENGTH OF STERLING IS ATTRIBUTED IN LARGE PART TO THE DECLINE IN U.S. SHORT-TERM INTEREST RATES AND UNCERTAINTY GENERATED BY NEW YORK CITY SITUATIO FOREIGN EXCHANGE MARKET SOURCES CONSIDER THAT STERLING'S DOWNWARD TREND WILL CONTINUE, CITING DETERIORATION IN THE UK'S TRADE POQITION IN RECENT MONTHS, (EVEN IF IT LEVELS OFF AT ITS PRESENT POSITION) COUPLED WITH AN INFLATION RATE SERIOUSLY OUT OF LINE WITH OTHER MAJOR INDUSTRIALIZED NATIONS. ONE MAJOR CLEARING BANK,BASED ON INFORMAL IN-HOUSE ESTIMATES, PUTS THE STERLING-DOLLAR EXCHANGE RA AT \$1.85 BY THE END OF 1976. ONE FINANCIAL ADVISOR (MAX WELL STAMP ASSOCIATES) SAYS POPULAR VIEW AMONG OBSERVERS IS THAT TRADE-WEIGHTED DEPRECIATION OF STERLING (NOW ABO 29) COULD WELL REACH 35 PERCENT BY NEXT SUMMER.

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20. UNDERWRITERS DISCUSSING EUROBOND MARKET OPERATIONS IN LARGE MEASURE ATTRIBUTE MARKET'S SUCCESS THIS YEAR TO THE DROP IN SHORT-TERM INTEREST RATES FROM MID-1974 HEIGHTS AND MORE NORMAL YIELD CURVE. THERE ARE VARIOUS ESTIMATES HERE OF THE IMPORTANCE OF OPEC BUYERS. SOME MARKET SOURCES ESTIMATE THAT OPEC BUYERS TAKE BETWEEN 10 AND 20 PERCENT OF TOTAL NEW ISSUES. QUANTITATIVE ESTIMATES OF SUPPORT IN 1975 ARE PUT AT BETWEEN 600 MILLION TO ONE BILLION DOLLARS, WITH ACTIVITY PRIMARILY FROM KUWAIT AND TO A LESSER DEGREE, SAUDI ARABIA. MAJOR U.S. INVESTMENT HOUSE REPORTS THAT SAMA WILL NOT TAKE MORE THAN 10 PER-

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CENT OF AN ISSUE AND WILL NOT DEAL FOR LESS THAN FIVE MILLION DOLLARS, SO THAT AN ISSUE MUST BE AT LEAST 50 MILLION DOLLARS BEFORE THE SAUDIS WILL PARTICIPATE. ALTHOUGH KUWAITI BANK INVOLVEMENT IS UNIVERSALLY CITED, THERE ARE DIFFERING INTERPRETATIONS ABOUT HOW IMPORTANT KUWAITI PARTICIPATION IS TO A PARTICULAR ISSUE. SOME SOURCES DOWNPLAY IMPORTANCE, SAY TOTAL KUWAITI INVOLVEMENT MAY NOT BE ABOVE 2 TO 3 MILLION DOLLARS IN A PARTICULAR DEAL AND IS NOT ESSENTIAL TO SUCCESS OF A PARTICULAR ISSUE. OTHERS CITE IMPORTANCE OF KUWAITI INSTITUTIONAL INVOLVEMENT, IF TWO OR 3 CAN BE INTERESTED, IT ALMOST GUARANTEES SUCCESS.

21. CONTINUED VITALITY OF THE MARKET HAS SURPRISED SOME OBSERVERS. PRIMARY MARKET CONTINUES TO ABSORB NEW ISSUES FAIRLY EASILY. ONE MAJOR NEW YORK HOUSE SAID EUROMARKET IN PAST 6 MONTHS MORE STABLE THAN US MARKET FOR SIMILAR TYPE ISSUES. UNDERWRITERS REPORT THAT THE PIPELINE OF NEW ISSUES IS STILL FULL INTO EARLY 1976. MARKET SOURCES WERE SURPRISED THAT SPATE OF RECENT CANADIAN DOLLAR ISSUES WAS ABSORBED WITHOUT DIFFICULTY. IN GENERAL, THE WEAKNESS OF THE SECONDARY MARKET IS CITED AS A CONTINUING HINDRANCE WITH THE SMALL SIZE OF THE ISSUES ALSO A FACTOR BEHIND LACK OF INSTITUTIONAL INTEREST IN EURO BONDS. BY COMPARISON WITH SITUATION A YEAR AGO, HOWEVER, SECONDARY MARKET IS CONSIDERED FIRM. BELIEF THAT U.S. CONGRESS WILL EVENTUALLY, AND PERHAPS SOON, VOTE TO REMOVE WITHHOLDING TAX ON FOREIGN PURCHASES OF US SECURITIES HAS LED AT LEAST ONE MAJOR US INVESTMENT HOUSE TO CONSIDER SETTING UP A SECONDARY TRADING ACTIVITY IN LONDON THAT WILL ALSO BENEFIT EURO-ISSUES.

22. A BLACKLISTED UK MERCHANT BANK SAYS DURING PAST SIX MONTHS, SITUATION HAS STABILIZED, WITH NO ESCALATION. THERE ARE STILL DIFFICULTIES IF ARAB FINANCIAL INSTITUTIONS, ESPECIALLY KUWAITIS, ARE CO-MANAGERS. IF UNION BANK OF SWITZERLAND OR KREIDT BANK LUXEMBOURG ARE LEAD MANAGERS, BLACKLISTED BANKS ARE OUT OF THE ISSUE. GERMAN AND US BANKS HAVE MORE GUTS, AND BLACKLISTED HOUSES CAN PARTICIPATE AS UNDERWRITERS WITH THEM, EVEN IF THERE ARE KUWAITI CO-MANAGERS. SITUATION CHARACTERIZED AS NOT SATISFACTORY, BUT STABILIZED, WITH LITTLE FEAR AT MOMENT OF

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EXTENSION OF BLACKLIST TO SUBSIDIARIES OF BLACKLISTED

FIRMS. THERE IS ALSO LESS ANXIETY SHOWN FROM BORROWERS
ABOUT HAVING LACKLISTED HOUSES ACT AS LEAD OR CO-MANAGERS

23. AS WITH PREVIOUS MESSAGES OF THIS SORT, READERS ARE
ADVISED TO TAKE IT ALL WITH A GRAIN OF SALT. OPINIONS
OUTLINED ABOVE BASED ON VIEWS OF SENIOR EXECUTIVES WHOSE
JUDGMENT IS EQUALLY RELIABLE BUT NO ONE HERE SEES THE
WHOLE PICTURE, HAS ALL THE ANSWERS. ABOVE IS FINANCIAL
ATTACHE'S BEST ESTIMATE OF THE SITUATION, BASED ON MARKET
OPINION. WE ARE TOLD EQUALLY VALID VIEWS ON THE SAME SUB-
JECTS EXIST IN FRANKFURT, PARIS, BERN, AND U.S. FINANCIAL
CENTERS.

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